



Philanthropic Foundations
foundations philanthropiques
Canada Canada

Submission

**To the
Standing Committee on Finance**

January 2012

Presented by

**Philanthropic Foundations Canada
Fondations philanthropiques Canada**

- *Philanthropic Foundations Canada is a national association with 110 members, including public and private foundations and other grantmakers.*
- *Our members held over \$7.5 billion in charitable assets at the end of 2009.*
- *PFC members made grants of \$192 million to Canadian charities in 2009 and spent \$ 117 million directly on charitable activities.*

Summary

Philanthropic Foundations Canada (PFC) is a Canada-wide membership association of charitable grantmakers, including public and private foundations. Our mission is to promote the growth of effective and responsible foundations and organized philanthropy in Canada. The grantmakers we represent contribute close to \$200 million every year to the wellbeing of Canadians and their communities through grants and investments in Canadian charities operating in the fields of education, health facilities, social services, arts, sports, youth programs and other supports that help Canadians and their families to lead more productive and creative lives.

Tax incentives for giving have played an important role in encouraging donors to gift their assets to private or public foundations, particularly in the last decade. Registered foundation endowment assets total about \$ 39 billion (as of end 2010 according to Canada Revenue Agency), and they provide a sustained source of yearly funding in the order of \$ 3.7 billion for the charitable sector in Canada. But tax incentives are not the only route to stimulating the provision of more capital for the sector. We believe that it is important to enhance the access of Canadian charities to funds that will enable them to innovate, grow and increase their effectiveness. The *Income Tax Act* regime for charities ensures that foundations make all of their grants to qualified donees (i.e. organizations recognized by the federal government). Loans and investments are complementary vehicles to giving as tools for financing the charitable sector. However, the option of making more funds available to registered charities in the form of loans or other investments is limited by the ambiguous interpretations of the *ITA*. Therefore we recommend that the Committee urge the government to clarify policy on program-related investing (or loans to charities) by foundations. Our other recommendation is that the Committee urge the government to re-examine the provisions in the *Income Tax Act* that prohibits the use of limited partnerships as an option for private foundation investors in charities.

Financing the Charitable Sector

Public and private foundations in Canada contributed about \$ 3.7 billion in grants to Canadian charities in 2010, according to the Canada Revenue Agency. The grants made by foundations are drawn from income from assets or from annual donations that benefited from federal and provincial tax credits at the time of giving. We appreciate the government's sustained tax support for philanthropic giving and we are encouraged by the acknowledgment of the importance of these tax incentives in the motion put forward by the Honourable Member for Kitchener-Waterloo that is now the subject of study by this Committee. In this context, we support the recommendation made by Imagine Canada for a stretch tax credit to increase new giving from Canadians at any level of income. We also acknowledge the value of the suggestion put forward by others that the government examine the possibility of extending the capital gains tax exemption on gifts of assets such as private securities or land.

It remains the case that Canadian charities, depending on their mission and activities, draw more heavily on their own revenue-generating activities than on charitable donations. According to Imagine Canada, almost half the funds generated by nonprofits to finance their activities are derived from earned income activities (fees, tickets sales, product sales etc). In general,

donations from individuals and foundations combined do not contribute more than between 13% and 15% of the financing available to the sector.

Typically, foundation grants permit charities to start a new program, try an unproven approach, carry out a strategic initiative or make an investment for growth. Private funders can be important catalysts for social innovation and entrepreneurial activity in the nonprofit sector. The government has repeatedly stated that entrepreneurship and innovation are key to Canada's sustained productivity. The 2011 Speech from The Throne referenced the importance of innovation at the community level: "Some groups, such as the homeless, persistently unemployed, and at-risk youth, face complex and continual social challenges and often the best solutions to tackling these difficult problems are found locally. All across Canada, citizens, businesses, charities and other groups, such as the Canadian Task Force on Social Finance, are working together to develop innovative ways to address local challenges."

The fact that the government chose to cite the **Task Force on Social Finance** was of particular interest to us, as this initiative was undertaken through the efforts of private funders. Its December 2010 report focuses on the critical importance of mobilizing private capital for social purposes. To quote from the Report, "social finance offers an unprecedented opportunity for Canada's charities and nonprofits to open up new sources of financing at a time when many are trapped in a cycle of short-term subsistence funding that diverts attention from their mission and impact, inhibits innovation, prevents them from expanding solutions that work, and threatens their sustainability. These organizations are, therefore, seeking complementary financing options that will provide them the flexibility and stability they need to focus on what matters most – effective and innovative approaches to serving the changing needs of Canadians."

PFC welcomes the discussion stimulated by this Report and is committed to working with other philanthropic support organizations to promote education and information-sharing on mission and program-related investing with the goal of increasing the availability of charitable resources for the benefit of the community and the public good.

Recommendation #1: Foster a regulatory regime that encourages program-related investment by private funders.

Charitable donations (grants and gifts) do not and have never provided sufficient funding to charities to meet all needs sustainably. Earned income and investment (loans, guarantees and private equity where feasible) are the most important sources of funding for many organizations in the nonprofit sector now and in future. We have recommended to the Committee on previous occasions that it encourage the government to develop a regulatory framework which fosters the growth of more philanthropic investment. This theme runs throughout the Report of the Task Force on Social Finance as well.

We specifically recommend that the Committee encourage the Ministers of Finance and Canada Revenue Agency to clarify the regulatory regime and to foster the practice of program-related investments by foundations. This type of investing (in the form of below market rate loans to charities) has had very little regulatory recognition other than in a CRA policy guidance document on community economic development first published in 1999.

Canadian foundations are increasingly interested in vehicles that will allow them to apply more of their invested assets for community benefit. A number have already embarked on mission-related investments in companies that operate in socially responsible ways or that work directly in fields of interest to them such as health care or housing. A few are experimenting with making program-related investments (PRI) which are typically loans made directly to charities and can be made at below market rates. For example, a private foundation has provided financing for a \$10 million mortgage to an education charity to finish construction of educational facilities at below market interest rates (and interest repayment deferred to end of the 5-year mortgage). In another example, a private foundation made a loan to a human services agency to purchase a transitional house, with initial value of \$200,000, repayable without interest over twenty-five years, secured by a caveat on the title. These loans are often made for housing and real estate investments because they have market valuations.

This being said, foundations are limited to providing below market rate loans to registered charities *only*. The *Income Tax Act* does not allow them to provide this type of charitable support to nonprofits such as housing corporations or other social enterprises.

CRA and Finance have been reviewing the current guidance on program-related investing so there is an opportunity for significant improvement. It would be of great help to charities and to charitable funders if the guidance on PRIs could make an explicit connection between the charitable objectives or purposes of an investor charity and the tool (PRI) that it chooses to use to achieve its purposes. For example, a foundation that has as its charitable purposes the relief of homelessness should be able to provide a PRI to a nonprofit housing corporation if it can demonstrate that this would lead to a reduction in homelessness (regardless of whether the housing corporation is a nonprofit or a registered charity).

We know that Canadian charities continue to have unmet need for debt finance and investment capital, to finance their facilities, bridge finance the acquisition of equipment, invest in "soft" capital such as business plans or human resource development and otherwise finance their growth. This is particularly true for the smaller charities. While debt capital is available from commercial institutions, the smaller organizations with multiple and unpredictable sources of revenue do not access it easily. There is a gap for unsecured debt for working and growth capital in smaller amounts. Loans from foundations can help to bridge this finance gap for small and medium sized charitable organizations. Federal encouragement of this activity will be of great benefit to many of them without incurring any significant fiscal cost to government.

Recommendation#2: Undertake a review of the ITA prohibition on limited partnerships as investments for private foundations

Federal and provincial statutes concerning charitable investments emphasize that charities must undertake only those investments prudently made with a secure expectation of return (for example, a secured mortgage loan at market rate to a housing corporation). The Canada Revenue Agency is of the view that investments made by foundations at below market rates to organizations that are not qualified donees are in fact prohibited gifts.

To provide a relevant example related to the discussion of opening up access to capital, we note that a nonprofit loan fund structured as an incorporated nonprofit would not be able to access foundation capital at less than market rate because it is not a qualified donee. This rule has limited the establishment and growth of nonprofit financial intermediaries. Such intermediaries cannot register as charities under the *Income Tax Act* definition of charities, although intermediaries that provide philanthropic venture capital to other charities have flourished under the broader definition of charity now found in the United Kingdom.

It is a fact that many foundations do not have the expertise or the resources to make and manage loans directly even though they wish to allocate some of their capital to more PRI activity. For this reason we need more intermediary organizations to facilitate the capital flows. One such intermediary is the Community Forward Fund (CFF), recently established with private funds to make loans and to provide financial advice to charities and nonprofits. However the CFF is not a registered charity which makes it impossible for foundations to provide grant support to it directly. The CFF established itself with a limited partnership structure, which is a common form of organization for this type of investment. Federal regulators have ruled that passive investments in limited partnerships by private foundations are not permitted because under the law of partnerships they could be construed to mean that the foundation is engaged in running a business, even if it is strictly a passive investment. So private foundations are barred from being either grantors or investors in an intermediary organization which fills the exact need they have for support in making more loan capital available.

We urge the Committee to recommend to the government that it reconsider the interpretation of a limited partnership as an investment that is barred to a private foundation. We suggest that this rule merits reconsideration in the case where such an investment can be demonstrated to further a charitable purpose. If the government were prepared to recognize the principle that a private foundation can enter into an investment-like vehicle such as a PRI even with a commercial entity as long as it furthers a charitable purpose, we think that it is logical to apply this principle to the situation of a limited partnership, with certain conditions related to the charitable purpose.

The two regulatory changes that we are suggesting would not incur any fiscal cost to government while stimulating considerably more availability of foundation capital for charities. We ask for your support in recommending these changes to the Ministers of Finance and the Canada Revenue Agency.

Thank you for your consideration.